



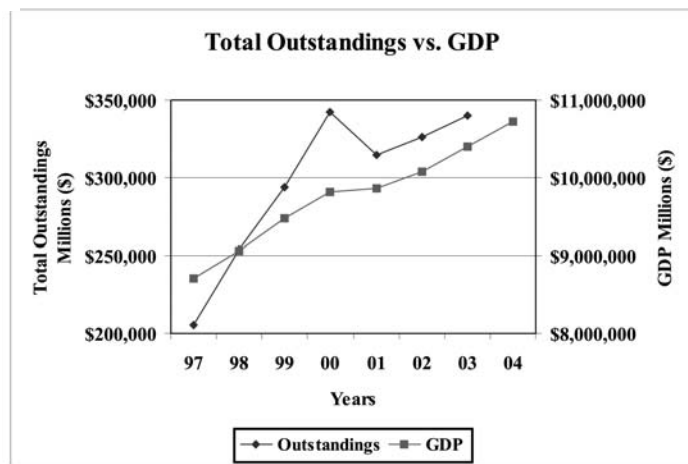
Report of Findings

(1) The good news for the industry in 2003 is that outstandings rose even faster than in 2002. Rising at 4.34%, they reached \$340.1 billion. Thus, they have climbed back to nearly their all-time high of \$342.7 billion in 2000. (See **Appendix Exhibit 1**). However, this growth rate is the sixth lowest since the SFNet began publishing this report 28 years ago, and three of these have occurred in the last three years. Also noticeable in **Appendix Exhibit 2** is the difference in its current 2001 - 2003 growth trend from that which took place during the previous 1982 - 1989 and 1991 - 2000 economic expansions. The compound rates of growth over these two periods was 18.59% and 16.94%, respectively. On the other hand, 2001 outstandings have only risen by 4.0%. Initial three-year “takeoff phase” (from an economic downturn) basis for the three periods, 1991 - 1993 produced a growth rate of 10.39%, while that from the earlier downturn was even faster at 17.03%. Thus, the current takeoff for the industry from this last recession has been much slower.

Using a continued comparison of the Real Gross Domestic Product with industry outstandings, as in recent reports, the strength of the GDP’s takeoff pattern is similar — 5.65% for 1983 - 1985, 3.00% for 1991 - 1993, and 2.66% for 2001 - 2003. Overall, then, industry outstandings are somewhat reflective of the present weak and uncertain upturn taking place in the economy. Using the ratio of outstandings growth to GDP growth, the real question is whether the industry is rebounding in a stronger or weaker manner than the economy. Unfortunately, it appears that it is the latter. In the 1980s, the industry’s rebound rate was 3.01 times that of the economy. In the 1990s, it was 5.65 times. However, the current rebound has been only 1.50 times that of the real GDP. One reason for this may be that while the current economic upturn has been solid, it may not be as robust as the two that took place earlier. This issue will be considered in the final forecast of this report.

Text Exhibit A compares the trend in the two measures over the past seven years and includes the first-quarter annualized preliminary figure for the GDP for 2004. As seen there, outstandings tend to move coincidentally with the GDP, but in a more pronounced manner. Thus, while the GDP increased this year by 3.12%, outstandings moved upward by 4.34%. Based on the preliminary June 2004 annualized figure of \$10.7 trillion, shown below, the GDP rose by 4.95% over 2002’s first quarter annualized amount. This bodes well for a stronger 2004 yearly activity for the industry. Thus, although the increase in the volume of asset-based outstandings remained sluggish in 2002, as indicated in both **Appendix Exhibit 2** and in **Text Exhibit A**, activity in the industry is both improving and likely to do even better next year.

Text Exhibit A

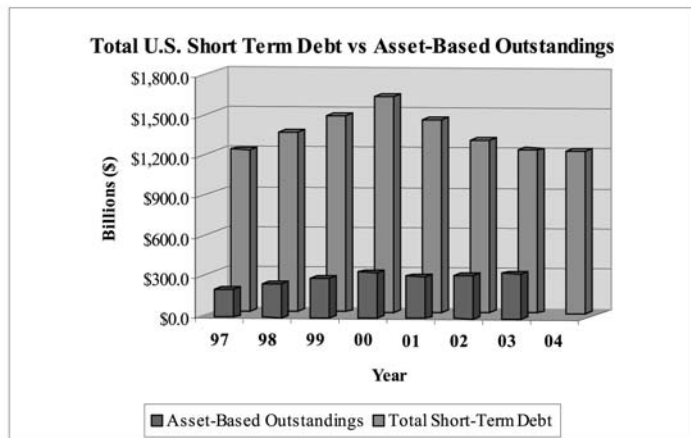


(2) The industry continues to increase the degree to which it provides short-term funds to the business sector of the economy versus its competitors. In every year since 1997, nonfinancial businesses in the United States have increased the proportion of their total short-term borrowing that is accounted for by the asset-based financial services industry. Over this period asset-based financing in the United States has increased from 14.26% of the total to 21.29% in 2003. The narrowing gap can be seen in **Text Exhibit B**. Moreover, total non-asset-based financing short-term debt outstanding has been declining absolutely since 2000, while asset-based financing borrowing has moved steadily upward since 2001. Despite record low and declining interest rates and the recent economic upturn, businesses have reduced their volume of short-term, non-asset-based financing borrowing by a total of \$396.0 billion over this period. They further reduced it by another \$5.8 billion through the first quarter of 2004. From 2001, such alternate borrowing declined by an average of \$113.1 billion each year. At the same time, asset-based outstandings have been on an upswing, rising by an annual average of \$12.9 billion. Another possible reason for this transformation in debt sourcing could be the growing lack of desire of other lenders to provide short-term funds to business. While data to test this is not available, supply-demand statistics on the long-term side of borrowing add credence to both propositions. In comparison to the short-term debt situation, and based on the latest Federal Reserve figures for 2003, total nonfinancial business long-term outstandings have continued to grow at a compound annual rate of 9.97% since 1997. Between 2002 and 2003, they rose by \$400.5 billion. Thus, while businesses continue to borrow long-term from other sources at a brisk rate, the short-term side asset-based financing is increasingly becoming the debt instrument of choice.

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Text Exhibit B



(3) While total outstandings provides one measure of asset-based financing activity, i.e., its volume, total advances is an indicator of the velocity at which such lending takes place. Thus, outstandings serve as the lending base from which borrowing takes place and advances reflect the degree to which loans are generated time and again from that base. In comparable Federal Reserve parlance, outstandings represent the “stock” of funds available for lending and advances represent the “flow” of funds that are being lent and re-lent from that stock.

As can be seen in **Appendix Exhibits 1 and 2**, total advances fell dramatically between 2000 and 2002. During those three years asset-based advances declined by \$464.4 billion. However, its pace turned around sharply, recovering 60% of that loss in just one year — 2003. Although the data history of this measure is short, having been collected only since 1997, it appears from the graph in **Appendix Exhibit 2** that advances are much more volatile than outstandings. Given this, it is also important to note that the timing, direction of movement in relation to one another, and size of their relative movements provide important signals respecting the industry’s response to current and impending economic change and business borrowing intentions. Prior to 2000, changes in and the size of advances appear to lead those of outstandings. In 2001, their directional movements were coincident. But, over the last two years, the turnaround in advances appears to have resulted to some extent from the steady upward growth of outstandings. All three of these aspects of their relationship can be seen in **Appendix Exhibits 1, 2, and 3**. However, there is more to the movement of advances than that of outstandings. This is shown more clearly in the latter two exhibits.

While outstandings are affected strongly by the overall economy, advances are driven by production demand. This is because borrowing is a derived demand. Companies borrow short-term to fulfill new orders and shortages in materials and supply inventories. They are not normally paid for their products until they are shipped to their customers. **Text Exhibit C** compares, in

three separate graphs, the movements of each of these three elements against that of advances over the last seven years for which we have compiled figures for this industry measure and for the annualized first quarter 2004 performance. As can be seen there, new manufacturing orders peaked out in 1999 at an all-time high of \$346.9 billion. This was a huge increase of \$27.8 billion over 1998. At the same time, in 1999, total advances reached what is estimated to be their all-time high of \$2.8 trillion. But in 2000, new orders fell by \$4.7 billion — and so did asset-based financing by \$285.4 billion. (The remainder of this drop is accounted for by declines in both wholesale and retail inventory volumes [not shown herein].) In 2001 orders dropped by another \$30.4 billion — and advances fell by \$408.8 billion. In 2002, the slow turnaround in new orders flattened out advances. In 2003, new orders jumped by \$32.7 billion, and so did advances by \$279.0 billion. The outlook for advances for 2004 is even brighter. On an annualized preliminary basis, new orders rose to the highest level in economic history — almost \$400 billion, and by the largest jump in history — \$44.0 billion. While the final 2004 figure will not be quite this high, it will continue to rise. Since advances appear to move with new orders, expectations are for another strong increase in asset-based financing velocity in 2004.

There are positive changes in both materials and supplies inventories (M&S) and in the value of shipments of manufactured goods. Trends in advances have followed these two measures by a year since 1997. This is as should be expected. New orders breed demand for materials and supplies to complete them, and then the resultant products must be shipped before invoices can be collected. As indicated in the second graph in **Text Exhibit C**, M&S moved steadily downward from 2000 through 2003, reflecting a runoff of short-term inventories, the type financed through asset-based financing. However, the preliminary first-quarter figure for 2004 indicates a buildup of \$3.3 billion for 2004, a turnaround of nearly \$10.0 billion since 2002. At the same time, the third graph shows the strong recovery in shipments that took place in 2003, an increase of \$29.4 billion and an even stronger one in 2004, preliminarily determined to rise by another \$43.0 billion — both the largest increases ever. In combination, the “push-pull” effect of these three measures provide solid support for a continued and strong rise in advances in 2004!

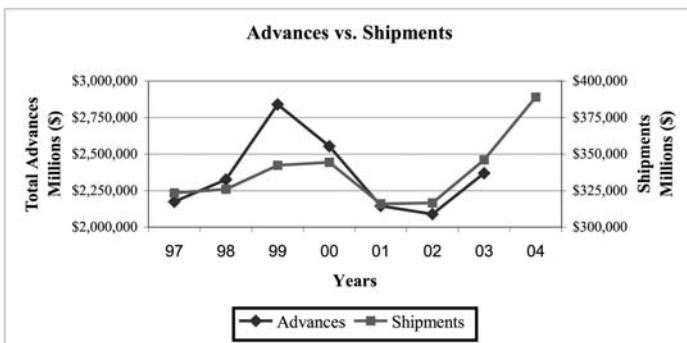
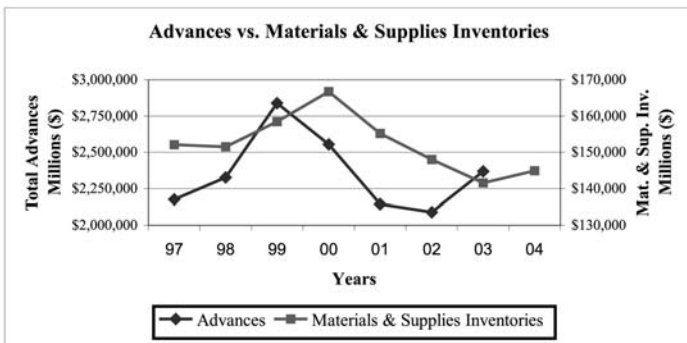
Before looking deeper into the industry’s activities in 2003, the comments made in 2002’s report (pg. 4) regarding the effect of interest rates upon them must be examined. At that time, the atmosphere of higher risk and lower interest rates created major disincentives to all short-term lenders, including those involved in asset-based financing. The Prime Lending Rate, the Federal Funds Rate, and short-term Treasury Yields had all continued to fall, though at a much reduced rate, throughout 2002 after the huge declines that took place over the previous five quarters (**See Text Exhibit D**). Thus, business performance in 2002 was both weak and tentative.

In 2003, however, (and into early 2004) the atmosphere has greatly improved. As shown in **Text Exhibit D**, all three of these bellwether interest rates bottomed out in the latter half of 2003. Furthermore, as shown in **Text Exhibit E**, both consumer and producer prices have remained stable, even accounting for the

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Text Exhibit C

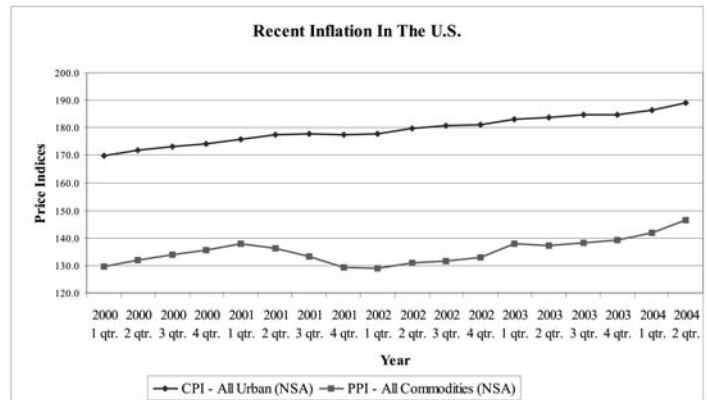


Text Exhibit D



effects of higher energy prices. In combination, all of these factors provided a positive environment that has kept the lending base growing while boosting substantially the velocity of asset-based financing that has been generated from it. Looking ahead, the early 2004 economic data provided in all of the text exhibits seem to call for continued growth in both outstandings and advances in 2004. However, there are a number of uncertainties that will be addressed in the forecast section of this report that could cause their movements to be less strong in the latter part of 2004.

Text Exhibit E



(4) Having completed the review of total outstandings and total advances, we turn more specifically to the performance of the top ten states in terms of their local outstandings. As can be seen in **Appendix Exhibit 4**, there were only minor changes in rank among these leading states in 2003. However, for the first time since 1996, Texas fell out of the top four dropping to number five while New Jersey moved up one spot to take its place. As will be discussed in the regional section, this is significant to understanding the differential economic atmospheres of these two areas in 2003. Several other states also switched positions. New York recaptured the number one spot from California, which fell to number two. Of important interest, Georgia continued to fall backward through the top ten. Beginning at number five in 2001, it has lost market share ever since. In 2003 it is in the ninth spot, having lost nearly \$4.4 billion in its lending base over this period. At the same time, located not far away, North Carolina moved back into the top ten for the first time since 1999 recapturing the tenth spot from Massachusetts. Between 2001 and 2003, total outstandings have risen by \$3.9 billion, making up for much of Georgia's loss in this region. Overall, the top ten states accounted for 63.78% of the total outstandings for all states, provinces, and other regions surveyed in 2003. This was slightly less than the 2002 figure of 64.68%. This loss in dominance only amounted to about \$3.0 billion in total among these 10 states.

(5) **Appendix Exhibit 5** presents a broader breakdown of 2003 outstandings as they were generated within each of the 50 individual states and the District of Columbia, within Canadian Provinces for which such data could be determined, and in all

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other regions in the world for which data was derived. A comparison of this exhibit with that contained in 2002's report reveals some unexpected results. Even though total outstandings rose by only 3.65% in 2002, more locales had positive increases, and many by large percentages, than did those in 2003 when the overall volume rose by a greater rate. In this current period, 27 states, the District of Columbia, the five Canadian provinces that reported volume for the last two years, the United Kingdom, and Other Europe had positive increases — a total of 35 of the 59 reporting locations. In comparison, in 2002 there were 38 states that reported increases out of 58 such jurisdictions. (All reporting Canadian Provinces, Europe and the Other category showed decreases in overall volume.) So, locationally, why was 2002's performance so bad while 2003's was so much improved? The answer lies in the greatly diminished activities that took place in just five states and Ontario in 2002. Together, New York, Michigan, Georgia, California, Texas, and Ontario in that order experienced declines totaling \$23.3 billion in outstandings. Interestingly, on the other hand, nine of the 38 states with increases had triple, quadruple-digit growth in 2002. Of these nine, five experienced negative growth in 2003. And only one, North Dakota, has continued to grow at this high rate for the second consecutive year, but it is a very small performing state.

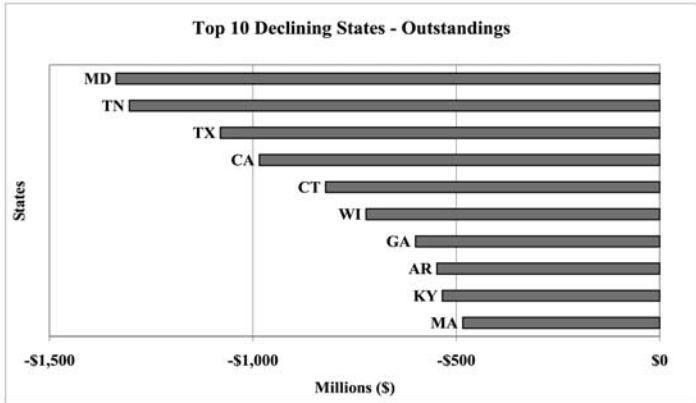
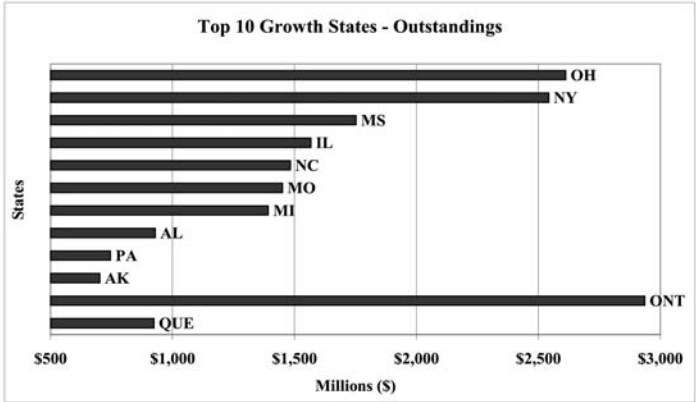
In 2003 an upturn took place because no location experienced large reductions in outstandings, while the Canadian provinces and Europe rebounded strongly. Three states had triple-digit growth rates and 14 more grew in double figures. As shown in the top half of **Text Exhibit F**, Ohio and New York had the largest volume changes over 2002, growing by more than \$2.6 billion and \$2.5 billion, respectively. This growth was the main reason for their upward movement within the top ten states. Mississippi, Illinois, North Carolina, Missouri and Michigan followed behind with increases ranging from \$1.75 billion to \$1.39 billion.

(6) From a more regional perspective, Canada has contributed greatly to 2003's turnaround in outstandings. In fact, as illustrated in **Text Exhibit F**, Ontario had the largest increase in lending volume of any locale having grown in 2003 by \$2.9 billion. And Quebec would have been in ninth position, if integrated among the states, with its large increase of \$924 million. Overall, its provinces' performance is a reversal from 2002 when Canada lost almost \$2.98 billion in total outstandings volume. Its volume in 2003 reached the highest level ever recorded at nearly \$7.6 billion. In 2002, asset-based financing outstandings in Canada's major provinces had been moving in the opposite direction from that of most of the states in the U.S. The lending base in every one of these areas exhibited declines even though the growth in the country's real GDP had begun turning around from its two-year weak performance. In 2003, early growth in the Canadian GDP fell off and then remained flat. In fact, the Canadian economy has

been rather weak. Unemployment has stayed at over 7.5% and, in the fourth quarter, real GDP grew at a year-over-year rate of only 1.6%. However, lending volume in all five of its continuously reporting provinces has grown at triple-digit rates. It is not clear why this divergent relationship is taking place. However, early signs of continued economic weakness remain in 2004 with first quarter real GDP growing at only 0.6%. Thus, it is not expected that outstandings in these provinces will continue to grow at these high rates in the future.

A closer examination of the rest of **Text Exhibit F** reveals that three of the top seven states, in terms of their increases in dollar volume, were located in the Eastern Midwest. In fact, as shown in **Appendix Exhibit 6**, this region had the highest growth among all sectors of the nation both in terms of absolute dollars and percentage change from 2002. (However, it should be noted that all of the international locations, including Canada exceeded its growth rate, but none did so in terms of its absolute dollar volume.) By comparison, in 2002 the Western Midwest had the largest growth in terms of both absolute dollars and percentage change. The area climbed by over \$7.5 billion, a nearly 51% increase over 2001. Nearly half of that gain was attributed to increased activity in Minnesota. Although the Western Midwest had a much smaller net gain in 2003 of only \$708 million, Missouri had the sixth largest increase among the top ten growth states with an increase of \$1.45 billion. The Western Midwest continues to grow, primarily because of the financing activities in

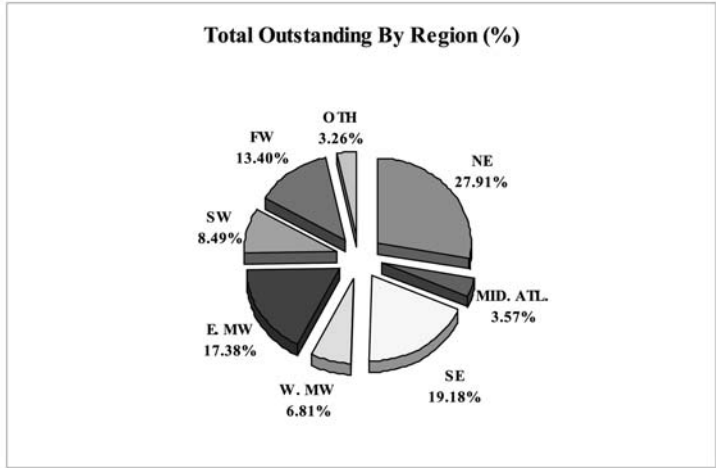
Text Exhibit F





Advances measure the velocity at which lending takes place, given the volume of outstandings. Thus, to emphasize this interrelationship, we continue to present both measures in the

Text Exhibit G



Minnesota and Missouri, but at a much reduced pace from 2002.

The bottom half of **Text Exhibit F** shows the ten states with the largest dollar volume decreases in 2003. These states are not concentrated in any one region, especially in comparison with the number of locales that make up each area. Maryland had the largest decline with a drop of \$1.33 billion, followed closely by Tennessee whose volume slipped by \$1.30 billion. It was Maryland, along with the decline in Virginia, that caused the Middle Atlantic Region to have had the poorest volume performance both absolute and relative terms in 2003. (See **Appendix Exhibit 6.**) Texas had the third largest decrease in outstandings, falling by nearly \$1.1 billion. Although Texas contributed the most to the decline in the Southwest Region, the outstandings volume in Colorado and Oklahoma also fell to a lesser extent. California's decline of \$984 million placed it fourth on the list and helped bump that state out of first place among the top ten states in 2003. As can also be seen in **Appendix Exhibit 6**, the weak performance of these states has been closely tied to that in their respective regions. Connecticut, Wisconsin, Georgia, Arkansas, Kentucky and Massachusetts round out the list with declines ranging from \$484 million to \$821 million.

Overall, the regional rankings in **Appendix Exhibit 6** remain unchanged from 2002. However, Canada and Europe had the largest percentage increases among all of the sectors. In 2002, the Western Midwest had the greatest gain. Since the recession in 2001, it has been the Eastern Midwest that has grown the most consistently. Not only is it the third largest territory in the 10-sector list, it is the only one to have shown positive growth over this period — 2000-2001, 6.35%; 2001-2002, 6.42%; 2003, 8.96%. It was these two areas that felt the earliest impacts of the last recession. Outstandings in the Eastern Midwest fell by 18.46% between 1999 and 2000 while those in the Western Midwest dropped by 1.53%. But in the recession year of 2000-2001, they dropped by 31.75%, the largest impact anywhere. Thus, the performance of these two areas appears to be a rebound from the past effects of the last recession. At this point in the current economic cycle, especially that which is beginning to show up in early 2004, it is difficult to determine where they will head in the future.

The pie chart in **Text Exhibit G** provides a percentage breakdown of the total outstandings accounted for by each of the regions enumerated in **Appendix Exhibit 6**. The areas along the eastern seaboard, which comprise the right-hand side of the chart, together, still continue to account for half of the asset-based financing done in the United States. These are regions where traditional industries such as textiles, apparel, footwear, and other manufactured soft goods are located and have been served for many years by commercial finance companies. However, more asset-based financing is moving outside of the East Coast and more of it is being directed to a much wider variety of less traditional industries.

same format as that for total outstandings. However, the results obtained for each are generally quite different. This is because the frequency at which funds are lent moves differently from the size of the base from which capital is made available to do so. The lending base of a company may not change, but the number of times it re-lends that base amount could vary widely depending on the rate of turnover of its available asset-based financing funds. Turnover depends upon both the volume and velocity of lending.

(7) The first area to be examined is the advances of asset-based financing in the states, provinces and those areas for which information is collected. Just as **Appendix Exhibit 4** presents the performance of the top ten states with respect to total outstandings, so does **Appendix Exhibit 7**, but here it is in terms of total advances. From a percentage basis, the top ten accounted for 64.63% of total advances for 2003, virtually identical to that for 2002. And, as indicated in this exhibit, there was no change in rank among the first five. However, there was some movement among those in the lower half of the table. Florida jumped two slots to number six and Georgia fell three positions to number nine.

Another measure of leadership among these areas is the stability of the top groupings. A comparison of **Appendix Exhibit**

Please note that there is a revision to **the 2002 Report's Appendix Exhibit 7**. North Carolina should have been in the number nine position in 2002, rather than having been omitted from that table (i.e., not included within the top ten states in terms of advances). Had the error not occurred, Minnesota would not have appeared among 2002's top ten States. Given this correction, in 2003 North Carolina moved up another slot to number eight. Pennsylvania and Ohio kept their positions at numbers seven and ten, respectively.

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4 for outstandings with **Appendix Exhibit 7** for advances in 2003, shows that the leadership states in the two are identical. However, both the positions and the change in those positions from 2002 are not. The states arranged by outstandings showed little movement, mostly one-position switches. By comparison, the spread of movement among those listed in the lower half of the top ten in lending advances ranged from -3 positions (Georgia) to +2 positions (Florida). In fact, over the past seven years the composition of the members of the top ten states in terms of outstandings has been far more stable than has been that respecting advances. It should be noted that this greater degree of variation is an outgrowth of the much larger (smaller) magnitude of asset-based financing that can be generated (or withdrawn) by lending and re-lending from the same base of outstandings than can be by changes in that base itself. As an example, if a firm's lending base increases (decreases) by \$100,000, that alone raises (lowers) its financing capability by that amount and no more. However, if its velocity of lending advances on that original base itself increases (decreases) by \$100,000 per month, the total volume of asset-based financing generated will increase (decrease) by \$1.2 million per year.

(8) **Appendix Exhibit 8** breaks down total advances by individual locations. Here we will discuss those findings as they relate to all of the states and international locales.

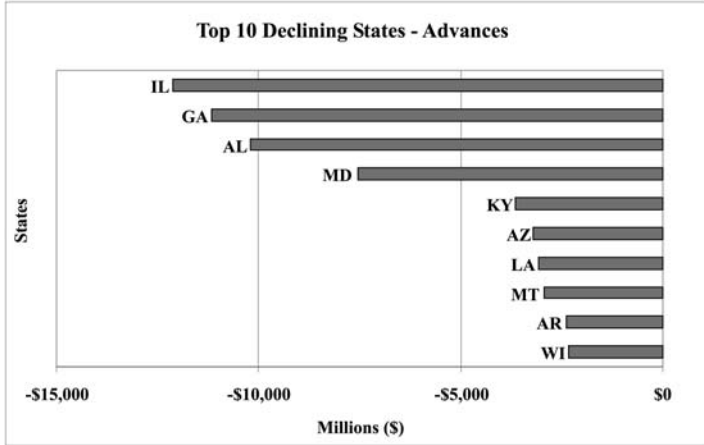
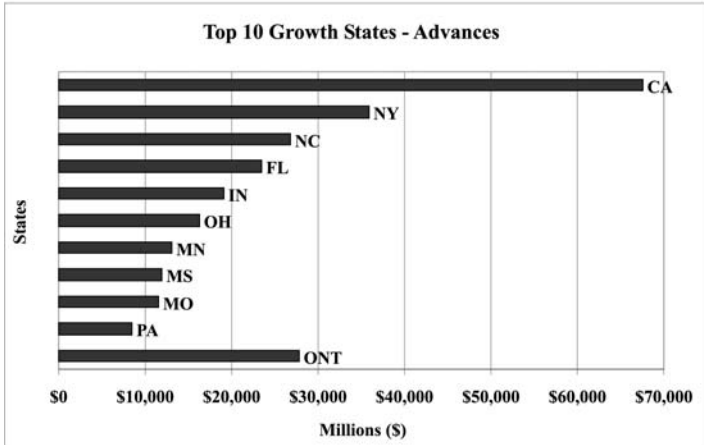
First, turn to North Carolina and the situation in the Southeast Region of the U.S. Already noted is Georgia's decline there over the last three years. However, North Carolina's has been even more impressive, but positively so. Not only have advances fallen significantly over the last three years in Georgia, but it has also done so in the other two large states there, Florida and Tennessee. Between 2001 and 2003, the decline in the three states has totaled nearly \$57.0 billion. North Carolina, however, has made up for this combined loss in advances. Over this period, it has generated \$46.6 billion in new lending. This has permitted the Southeast to maintain its position as the second largest lending region in the world over this post-recession period.

Looking at the rest of the data presented in asset-based financing and comparing its results with those based on outstandings in **Appendix Exhibit 5**, one finds that more locales showed slightly more increases in advances than in outstandings. And this is to be expected given the large increase in advances in 2003. In all, 31 states, the District of Columbia, all five reporting Canadian provinces and the Other Europe category experienced higher asset-based financing advances in 2003 than in 2002 — 38 locales in all. In comparison, as presented earlier, 27 states and the District of Columbia, all five reporting Canadian provinces, the United Kingdom and Other Europe increased their lending bases — a total of 35 separate jurisdictions. Interestingly, while the U.K. exhibited an upturn in outstandings in 2003, its volume of advances fell off slightly. This is the opposite of 2002's move-

ments and implies an overall net increase in loan collections since 2002. These findings also indicate the importance of examining local short-term borrowing environments rather than just relying on overall measures of these lending components. They also have major implications respecting asset-based turnover, the most important measure of the industry's overall lending efficiency.

Text Exhibit H examines the largest dollar increases in advances among the various jurisdictions in the United States and Canada. As shown in its top half, California and New York had the largest volume changes over 2002 growing by \$67.5 billion and \$35.9 billion, respectively. Despite California's huge growth in advances in 2002, it was still unable to retake the top spot from New York. North Carolina had the third most impressive performance increasing by \$26.8 billion. Florida, the Southeast Region's largest state in terms of asset-based financing, had an impressive \$23.5 billion upswing in 2003. However, this was not sufficient to recover from its huge \$45.9 billion loss in the previous, recession year of 2001. Indiana and Ohio had the fifth and sixth largest volume growth in advances. This helped to offset the declines that occurred in Illinois and Kentucky and allowed the Eastern Midwest Region to achieve a solid 9.79% gain. Minnesota, Mississippi, Missouri and Pennsylvania rounded out the top ten with growth ranging from \$13 billion to \$8.4 billion in new 2003 advances.

Text Exhibit H



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The continued growth in Minnesota and Missouri helped the Western Midwest to a respectable gain despite the fact that six of the ten states within this region had reduced advances in 2003. Although in 2002 the region grew by 114%, 2003's growth of 12.63% was still second among all U.S. regions.

In Canada, Ontario had a strong gain of \$27.8 billion in advances. This would place it third in increased lending among all Western Hemisphere locales. In fact, Ontario has gained back more than the \$24.6 billion record loss it had in 2002 (i.e., +\$27.8 billion). As a result, its total advances this year reached \$43.2 billion, eclipsing its previous all-time high in 2001. As with outstandings, the Canada's total volume in 2003 also reached its highest level ever at \$68 billion.

The bottom half of **Text Exhibit H** shows the ten states with the largest dollar volume declines in advances in 2003. Unfortunately, Illinois suffered the biggest decline in new asset-based financing with a \$12.1 billion loss in 2003. However, this drop was more than offset in the Eastern Midwest by the large gains in Indiana (#5), in Ohio (#6), and Michigan (#11) that totaled \$43.6 billion. Two Southeast Regional states, Georgia and Alabama, followed closely behind Illinois with declines in advances of \$11 billion and \$10 billion, respectively. These losses, as well as smaller declines in Louisiana and Arkansas, were counteracted by the large gains in North Carolina and Florida. These enabled the Southeast Region to achieve the third largest gain in lending velocity both in terms of absolute dollars and percentage change among the seven U.S. Regions. Maryland followed in fourth place and was the only state in the Middle Atlantic Region to record a loss in advances. Kentucky, Arizona, Montana and Wisconsin completed the list with decreases in advances ranging from \$3.7 billion to \$2.3 billion.

Appendix Exhibit 9 offers regional performance results in terms of total advances. This table in combination with that of **Appendix Exhibit 6** provides the elements of the important turnover results that are presented in **Appendix Exhibit 10**.

(9) On an absolute dollar-volume basis, **Appendix Exhibit 9** indicates that advances in the Far West region grew the fastest among all ten sections of the U.S., Canada, and the rest of the world. In fact, only Canada had a larger percentage gain. Six of the nine states in this region increased in their lending velocities with California leading the way as the number one growth area. This is in sharp contrast to 2002 when this region experienced the largest dollar and percentage decrease among all U.S. regions. The Far West region appears to be the last area in the U.S. to finally be rebounding from the last recession. Much of the reason for this is the huge increase in government defense contracting that has been taking place since the start of the war in Iraq. The Northeast continued its strong performance, although less so than in 2002. Its growth was second only to the Far West's \$65.8 billion with an increase of \$58.2 billion. All of the states within this region, with

the exception of Vermont, exhibited positive growth in 2002. However, New York alone was responsible for \$35.9 billion of this total.

The Southeast Region also rebounded from 2002 and was the third fastest-growing U.S. region on both an absolute dollar and percentage change basis with increases of \$42.2 billion and 10.07%, respectively. 2002's second-strongest growth region, the Western Midwest, continued to move upward, but only at a quarter of the volume increase it enjoyed in 2002 at \$19.3 billion. Although only four states in this region exhibited increases in advances — Minnesota, Missouri, Iowa, and Kansas are among the top five of the 10 states located in the region. By comparison, Canada had the third-highest dollar volume increase and largest percentage change of the 10 regions. This was mainly due to the increased asset-based financing activity in Ontario and Quebec.

Text Exhibit I portrays graphically the states that contributed the most to their region's level of advances and that had the weakest performance there. Each region is numbered clockwise to distinguish it more clearly from its neighbors. Alaska and Hawaii are not shown in connection with their region, five. The exhibit is intended to put the special relationships between U.S. regions, states, and their performance into a more meaningful, interrelated perspective.

Text Exhibit I



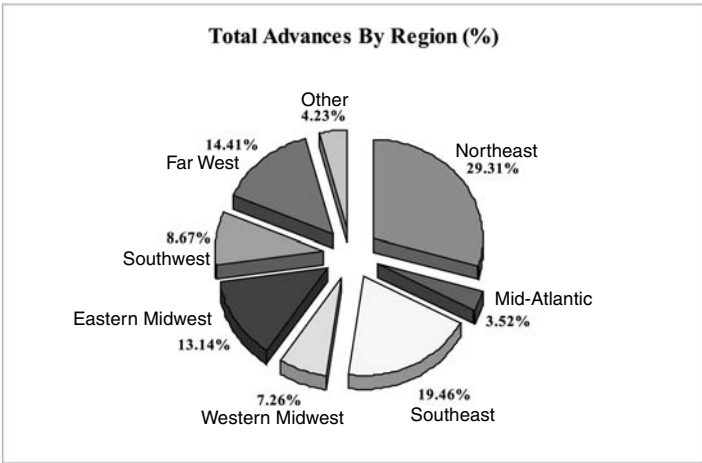
- 1 – Northeast (MA, ME, NH, CT, RI, VT, NY, NJ, PA)
- 2 – Mid-Atlantic (VA, WV, DE, MD, DC)
- 3 – Southeast (NC, SC, TN, AR, MS, LA, AL, GA, FL)
- 4 – Southwest (OK, TX, CO, NM)
- 5 – Far West (AK, HI, WA, OR, CA, ID, UT, NV, AZ)
- 6 – Western Midwest (ND, SD, MT, WY, NE, KS, MN, IA, MO, WI)
- 7 – Eastern Midwest (IL, IN, KY, OH, MI)

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Text Exhibit J presents a breakdown of advances by region for 2003. An examination of this pie chart indicates similarly to that for outstandings in **Text Exhibit G** that the East Coast splits total advances with the rest of the nation. In 2003, this portion of the United States produced 52.29% of this total. In comparison, it

Text Exhibit J



created 50.7% of total outstandings in 2003. Together, these results strongly imply that the overall demand for asset-based loans was higher and moving faster in the East than anywhere else in the world.

There are several underlying trends that indicate the Eastern Seaboard is not necessarily where the trend of future growth lies. First of all, the continuing declines in Georgia indicate an important weakness in the heartland of the Southeast. Second, the strong performance of the Eastern Midwest indicates that while economic growth there has been stagnant to declining, the industries that remain there are turning increasingly to this form of lending to support their activities. Third, recent high growth of the two major eastern provinces in Canada, Ontario and Quebec, also provides evidence of the substantial interest there in using the lending facilities of asset-based providers. Finally, the strong performance in the UK shows that there is a strong awakening of interest in this form of borrowing among Europeans. Indeed, recent articles in various financial publications support the fact that this trend is taking place in a manner that is stronger than ever.

(10) **Appendix Exhibit 10** presents the industry's rates of turnover both on a regional basis and in total for all areas in 2002 and 2003. During this period, overall industry turnover rates have increased for the first time since 1999. This was due to the large increase in total advances relative to a smaller rise in total outstandings. This combination provides a bellwether indicator of further growth in lending in the future, i.e., at least through the

first half of 2004. More specifically, 2003's turnover rate was 6.97 times, an increase of 8.7% over 2002's 6.41 times. While this may appear to be a relatively small change, this difference in turnover put over \$190 million of new asset-based financing into the marketplace in 2003. In part, it is the growth in the economy that has taken place in 2003 and that continues in 2004, and the resultant demand for additional short-term funds that it has helped to generate, that has created this strong positive environment for the industry in 2003 and that should continue to do so in 2004. The industry's overall rate of new lending has also increased and should also carry on into 2004 because commercial banks and other competitive forms of short-term lending are unwilling or unable to supply the forecasted increasing demand for such funds. 2003's continued low interest rates will remain for 2004 and will keep such capital supply on the sidelines while offering added lending opportunities, created by this gap, for the industry.

An examination of regional turnover in **Appendix Exhibit 10** continues to show that internationally, the speed of lending has been much greater than in North America. Between 2002 and 2003, the rest of the world turned asset-based funds at a rate of 9.13 times. Although it is a decline of 27.94% from the previous period, it remains higher than any in U.S. region or province in Canada. It is important to note that the "Other" grouping covers Non-European and the "rest of the world." Thus, it reflects many diverse businesses, demands, and financial activities and along with wide variance in their degrees of sophistication and experience.

Within the U.S., the Far West not only had the highest turnover, but at the fastest growing rates. Asset-based financing dollars there turned over at a rate of 7.49 times, or once every 48.7 days. Moreover, the Far West's lending speed rose by 22.39% over that of 2002. This level of improvement was due to the fact that it had the largest increase in total advances. In particular, California had the largest growth in advances of any state in the Union or elsewhere in the world, increasing by \$67.5 billion in 2003. It was also bolstered by Alaska, which had the highest growth rate in advances, reaching over \$5.6 billion in new lending. In contrast, the Far West Region remained flat in terms of outstandings. However, California itself had nearly a \$1.0 billion decline in outstandings, the fourth largest among all of the U.S. states as well as the other locales in the world. This indicates that while new lending activity is on the increase in this region, asset-based lenders have not expanded their lending bases. The primary reason for this has been the weak economic atmosphere in the West, especially in the high-tech industries and in those that are dependent on uncertain defense spending and the airline industry.

The Western Midwest and Northeast had the second and third highest speeds of lending in 2003. Turnover in these two regions was at 7.43 times and 7.31 times, respectively, or between 49 and 50 days each. Both of these regions had much more modest percentage gains, of 8.30% and 5.48%, than did the Far West. Although the Western Midwest had a relatively strong increase in lending activity, it was nowhere near as large on a dollar volume basis as most of the other U.S. regions. In contrast, the outstandings in this region remained relatively flat despite the fact that Missouri had the sixth largest dollar volume increase



among the states. The Northeast, which far exceeds all other areas in terms of both the size of outstandings and advances, had the second largest volume growth in advances with only a modest increase in outstandings. Both the Southwest and Middle Atlantic also had increases in lending speed over 2002. However, in both of these regions, outstandings declined in combination with modest gains in advances.

(11) Despite the general increase in turnover in the United States in 2003, no domestic region came close to that in either Canada or Europe. As shown in the **Table**, European asset-based lenders generated \$9.50 in loans for every dollar in their lending bases. While Europe had the largest decline in turnover from 2002, on average these providers still turned over their lendable funds once every 38.4 days in 2003, more than 10 days faster than anywhere in the U.S. Their decline in turnover was caused by an increase in their lending base, but with a coincident drop in their new lending activity. The latter was due to the loan consolidation that took place from 2002's high volume. Also shown in the **Table**, Canadians had the second highest rate of loan turnover. At a 9:1 turnover ratio, they moved funds at an average rate of once every 40.6 days. As pointed out earlier, lending rose as a result of the substantial increases in all Provinces in both outstandings and advances.

The **Table** also presents the turnover rates by region since 1997. This was the first year that the SFNet began collecting data on advances, a necessary component in the determination of turnover. In order to highlight the trends that have taken place over the period, we have **shaded** the peak turnovers that have occurred in each region and the troughs that took place among them.

In total, over this time frame the turnover rate fell almost steadily until 2002. In fact, 2003's increase, although small, (as stated earlier, about \$190 million) it is the first to have taken place since 1998. A closer examination of the table however, reveals important differences in the underlying regional movements. In every area, with the exception of Europe, turnover rates peaked out between 1997 and 1999. Surprisingly, in most of these, the maximums occurred nearly two years before advances reached its peak. As can be seen in **Appendix Exhibit 1**, this is because the asset-based financing base generally grew faster than did the advances generated from it. The slower lending rate throughout the U.S., Canada, and other areas may well be a symptom of the weaker underlying economy that prevailed during the high-flying stock market years that preceded the 2001 recession. The almost universal weak bottoming out that appears to have taken place in 2002 and that is indicated in 2003 is indicative of a still weak economic recovery that underlies more positive news and prognostications being made in the press. The fact remains from the **Table** that turnover rates in all of the U.S. regions, in Canada, and elsewhere fell steadily since 1999 and that although all of these U.S. regions had increases in turnover in 2003, they are all still below their 1999 levels.

Interestingly, the opposite trend has occurred in Europe. As shown in the **Table**, turnover in Europe bottomed out in 1998 when a combination of soft economies and the adoption of the Euro combined to make the lending environment there more risky. Although it peaked at 13.03 times in 2002, the second highest rate of lending and re-lending shown anywhere in the **Table**, it still remains in 2003 at almost the highest of any of the regions. Outstandings there have grown somewhat while advances have remained steady. This combination bears watching as it indicates a possible economic slowdown there in 2004.

ADVANCES VS. OUTSTANDINGS TURNOVER RATE
BY REGION — (1997 - 2003)

Region	1997	1998	1999	2000	2001	2002	2003
Northeast	11.09	11.87	9.13	7.12	5.35	6.93	7.31
Southeast	11.10	8.96	8.94	7.81	7.98	6.61	7.07
Far West	11.27	7.56	8.01	7.91	8.10	6.12	7.49
Eastern Midwest	9.00	9.34	11.74	6.77	6.59	5.22	5.26
Southwest	11.47	7.10	10.14	7.65	8.07	6.47	7.11
Western Midwest	9.48	8.59	8.31	9.09	4.78	6.80	7.43
Middle Atlantic	10.13	10.93	14.30	6.26	5.88	5.84	6.88
Canada	6.63	10.74	7.99	8.70	8.25	5.74	9.00
Europe	5.39	4.14	N/A	5.82	8.21	13.03	9.50
Other	13.72	4.42	N/A	5.83	7.25	3.61	2.34
Total	10.60	9.15	9.54	7.45	6.82	6.41	6.97

(12) It should be pointed out that the above trends for the industry have not been totally unique to it. On the next page is an extension of the above table to reflect total short-term lending turnover for all U.S. nonfinancial businesses between 1997 and first quarter 2004, regardless of borrowing source. As can be seen there, turnover for all forms of short-term debt peaked in 1998 and bottomed out in 2001 - 2002. The overall turnover rate is much lower than the industry throughout the period because of the generally longer length lending instruments used by other short-term funding providers. Even in the shortest collection year shown, it took these institutions an average of 304 days to collect their outstandings. The negative values indicate that net reductions in outstandings exceeded advances in the years indicated. Thus, in 2001, the overall lending base of non-asset-based financing providers fell by nearly 30%, relative to the decline in advances. In fact, between 2001 and 2003, the data indicates that non-asset-based financing outstandings have fallen 25.4% faster than have their advances. It has only been in the first quarter of 2004 that such outstandings and advances have begun to right themselves again. Thus, in comparison with the total of other forms of borrowing, asset-based turnover has far exceeded that of its competitors over the last seven years. In fact, according to federal reserve flow of funds data, the rate of growth in total domestic non-financial business debt (long-term and short-term combined), fell from 12.2% in 1998 to just 2.9% in 2002. While it rose to 4.3% in 2003, this was because of a strong second quarter showing of 5.9%. So far, in the first quarter of 2004, it has risen by only 4.1%. In total, these results indicate that despite continued low short-term interest rates, borrowing remains weak in the U.S.



ESTIMATED TOTAL NON-FINANCIAL BUSINESS SHORT-TERM
BORROWING TURNOVER RATE — 1997 - 2004(Q.1)

Year	1997	1998	1999	2000	2001	2002	2003	2004I
U.S. Total	1.19	1.20	0.99	1.11	-1.42	-1.40	-1.20	-0.13

**Source: Federal Reserve*

One of the primary stimulants of loan turnover is the opportunity for providers to diversify lending risks by participating out that portion of those deals that create excessive exposure to themselves. Thus, loan participations provide a method for examining the manner and degree to which asset-based and all other types of loans are being “packaged”. Loan packaging is carried out for a number of reasons. First, it allows smaller lenders to consider funding situations that are generally beyond their individual capacities to do so. Second, it allows such providers to take part in the packages of others. Third, this arrangement also permits larger commercial finance companies to participate out opportunities that are too small for them to handle efficiently or without consuming staff time that is otherwise needed to service much larger borrowings. Finally, as mentioned above, participations allow lenders of all sizes to spread their funding risks over a wider and/or more diverse portfolio of borrowers.

In theory, participations should be expected to rise as the economy improves. Such activity reduces risk exposure as loan volume and size grows by allowing lenders to diversify their portfolio risk. Similarly, as the economy weakens, loan demand falls and one should expect the volume of participations to decline. A comparison of **Appendix Exhibit 11** with that contained in 2002’s report provides a means for assessing this situation. Both provide regional breakdowns of loan participations for 2002 and 2003, respectively.

(13) Overall, in 2003 advances rose by a robust 13.35%. An examination of **Appendix Exhibit 11** indicates that this was driven largely by the very strong turnaround in sole lender originations. Rising by 43.30% over 2002, originations added \$130 million of the \$279 million total growth in advances in 2003. However, they remain \$811 billion under that for 2001 and over \$1.3 trillion below 1999’s record year of \$1.75 trillion. The other primary contributor to the total advance volume continues to be asset-based financings generated by sole lenders. This form of asset-based financing comprised 76.2% of all advances in 2003. It grew by \$146.1 billion in 2003, an 8.81% gain over 2002. At a bit over \$1.80 trillion, sole lending by individual asset-based financing firms set a record in 2003.

A comparison of **Appendix Exhibit 11** with corresponding exhibits in previous asset-based financing surveys provides a less rosy picture for nonlead participations. The comparison indicates that nonlead participations have been a relatively small and declining portion of total advances over the last three years. The

trend is most likely a reflection of a recent decline in loan sizes. Typically, larger loans necessitate greater participation to achieve successful closings than do relatively small sized lending arrangements. Interestingly, with the exception of 2001, nonlead participations have dropped significantly since 1999. In that year they amounted to over \$800 billion — 28.2% of all advances. Large scale borrowing was created in 1999 by the then strong economy and falling interest rates; lead lenders accounted for only 10.2% of the total. Since that time, participative lending has declined to \$134.3 billion, only 5.67% of total annual advances.

Looked at from a more recent perspective, nonlead participations hardly moved from 2002. Growing at only 2.09% over 2002, the small change is symptomatic of the uncertainty that has prevailed both in the lending markets and among business borrowers in 2003. As stated earlier, the lack of nonlead participations is indicative of economic weakness. The slight increase that took place in 2003, however, is more predictive of uncertainty as to which way the economy is moving now and that it is likely to do so in 2004. Nevertheless, the across-the-board absolute dollar increases that have taken place in all segments of advances certainly provides a stronger and more positive message regarding the lending environment in the industry in 2003 versus that which took place in 2002 when only sole lender activity increased.

(14) The table on the next page, along with the loan participations’ **Appendix Exhibits** for the last two years, also shed light on the asset-based financing atmospheres among the surveyed regions.

As might be expected from the earlier discussion respecting the growth in advances alone, the Far West, Western Midwest and Southeast had the highest growth in sole lending since 2002. In combination, while asset-based lenders in the Middle Atlantic, Western Midwest and Southwest regions of the U.S. were the most willing to do individualized loans, loan demand for this type of borrowing grew the most in the Far West, Western Midwest and Southeast. Thus, loan demand for a particular form of asset-based loans is not always carried out in the same areas where lenders are most anxious and willing to do them.

As shown in the table, sole lending was strongest in the Middle Atlantic, Western Midwest, Southwest, and Far West regions of the United States. In each of these areas over 78% of the member portfolios were lent out exclusively by individual asset-based firms. Furthermore, the absolute rate of relending in these areas was also substantial (see **Appendix Exhibit 11**). Since it takes less time to borrow through a single institution, i.e., there is less time involved than in packaging a loan, both the absolute and relative measures imply that, in general, these regions were the most conducive in which to borrow. From the standpoint of packaged loans, lead lender originations increased on both a dollar-volume basis and on a percentage basis of total advances in nearly every region. These increases took place with the exception of the Western Midwest and Middle Atlantic areas, the two regions with the highest sole lender activity. Lead lending dropped from 16.4% to 13.4% and 12.32% to 6.92% of total advances, respectively, in these two areas over 2003. On the other hand, sole lending activity in these two locations rose from 78.51% to 80.93% and 77.12% to 84.10% during this period.

Asset-Based Lending Survey

Asset-Based Financial Services Industry

LOAN PARTICIPATION BY REGION - 2003
(AS A % OF AND RANKED BY AREA TOTAL ADVANCES)

Region	Sole Lender	Lead Lender Originations	Non-Lead Participation
Northeast	72.85%	23.00%	4.15%
Southeast	76.63%	17.74%	5.63%
Far West	78.99%	16.34%	4.67%
Eastern Midwest	71.70%	20.66%	7.64%
Southwest	79.97%	10.65%	9.38%
Western Midwest	80.93%	13.37%	5.70%
Middle Atlantic	84.10%	6.92%	8.98%
Total - U.S.	76.06%	18.17%	5.77%
Canada	68.05%	27.08%	4.87%
Europe	100.00%	0.00%	0.00%
Other	100.00%	0.00%	0.00%
Total - 2003	76.15%	18.18%	5.67%
Total - 2002	79.32%	14.38%	6.30%
Total - 2001	57.89%	34.07%	8.04%
Total - 2000	66.25%	26.57%	7.18%

While the volume of Canadian advances is smaller than that of any region in the United States, asset-based financing there climbed by nearly 400% over that which took place in 2002. Canada also has the lowest proportion of sole lender asset-based activity, as shown in the table. Moreover, such activity fell from 73.53% of total advances in 2002 to only 68.05% in 2003. At the same time, lead lender originations rose substantially as a percentage of total advances in Canada from 21.49% to 27.08% during 2003. Finally, nonlead participation asset-based financing has been both very small and virtually constant at about 4.9% of the total. The implications of these results are that, perhaps even more than in the U.S., a significant degree of economic uncertainty continues to prevail there.

Finally, as can be seen from the trend in the annual totals presented at the bottom of the table, there appears to be a significant difference in the forms in which asset-based financing has been taking place since the recession of 2001 and the coincident 9/11 attack that took place at that time. Before 2001, 20% fewer of all deals were done by single lenders. Since that time, nearly $\frac{4}{5}$ of them are nonparticipations. While originations have begun to recover, nonlead participations have not and remain far lower than that which took place in the late 1990s. The lack of diversification since 2001 is, in part, a function of the large reduction in advances and in outstandings that have taken place in the 2000 and 2001 periods and that have just begun to recover. It is also a function of the continued economic uncertainty that has prevailed since the invasion of Iraq and its impact both economically in the United

States and on oil prices and availability throughout the world. Finally, and as a result of these, it is also a function of loan sizes.

As stated in previous reports, the contributions of the asset-based financing service go far beyond their direct effect on the business operations of the recipient companies. The next several sections of this report present a series of assessments of these direct and indirect impacts in 2003. **Appendix Exhibits 12 & 13** present data on these effects both in total and by specific location.

(15) As indicated in **Appendix Exhibit 12**, over 21.1 million employees were affected both directly and indirectly by their companies' asset-based borrowings in 2003. This represents an increase of over 1.4 million more jobholders than reported in 2002 and more than 2.5 million since the recession of 2001. In 2003 the job-impact gain topped 2002's 7.3% versus 6.0%. However, the worldwide effect is most certainly much larger than this. Although we received definitive information as to the estimated number of client companies that utilized asset-based financing facilities in 2003, we did not obtain similar information as to the number of people they employed overseas. This is the most difficult data for respondents to provide, and it is even harder to do so for their overseas clients. In order to partially overcome this problem, we have developed estimates of the industry's employment impact in Europe. The estimate in 2003 is over 4.1 million European client company employees were directly or indirectly impacted by the industry's funding activities. Thus, in total, the industry's worldwide impact upon its clients' employees was 25,285,556, 2002's adjustments led to a revised estimate of 20,992,318 such individuals. Therefore, on a revised basis, the overall net gain in 2003 was over 4.3 million employees. This is a huge increase over 2002's gain of only 1.2 million affected employees.

In 2003, in the U.S. alone, 21.0 million client company employees were impacted either directly or indirectly by the industry's asset-based financing, or about 15.2% of all job holders in this country. This is up very slightly from 2002's 15.1%. However, this difference amounts to an increase of almost 138,000 additionally affected workers. Moreover, if one applies the often-used rule of thumb that for every employee of a firm, 2.5 workers in related businesses are needed to support their activities, then in 2003 the asset-based financial services industry members affected, both directly and indirectly, nearly 88.5 million wage and salary earners worldwide, an increase of 15.0 million more people in 2003 than 2002. For only the United States, the comparable figure was 73.5 million workers. This represents 53.4% of all of the 137.7 million workers employed in the United States. All of this occurred while unemployment in this country continued to rise; in 2003 by another 4.7%. What is most important is that the employment rate, despite the economic upturn in 2003, rose by only 0.9%.

(16) Presented in **Appendix Exhibit 12** is information on the number of client companies that were involved in asset-based borrowing from the industry. While the number of such firms engaged in this form of borrowing still represents only a small portion of American and, indeed, the world's total, their size is not



inconsequential. On average, each asset-based borrower received advances of nearly \$30.7 million in 2003. This is up by more than \$2.2 million per company from 2002's \$28.4 million. As pointed out in 2002's report, although many of these firms are much larger than average, they are balanced out by many more smaller borrowers. Nevertheless, the number of these borrowers rose by 3,761 over 2003's all-time high to a new record of 77,220 in 2003. In 1976, when the SFNet began publishing such data, there were only 5,507 client companies that used such services. Thus, the number of companies using asset-based facilities has grown over this period at a compound annual rate of growth of 10.3%.

Although data on advances was not collected before 1997, compilations respecting outstandings were. Therefore, comparisons as to the size of borrowing by these client companies can only be examined from a lending-base perspective prior to that time. In 1976, the average volume per borrower on the books of asset-based lenders was \$2.2 million. In 2003, despite the new record number of such borrowing companies, average outstandings per asset-based borrower remained at 2002's doubled amount of \$4.4 million.

Because we do have data on advances since 1997, we can assess the recent level of new borrowing by the average asset-based financing client company. More specifically, the volume of such borrowing rose from \$28.4 million to \$30.7 billion in 2003. This is an increase of 7.83% over 2002. Furthermore, in combination, these data on outstandings and advances indicate a higher rate of turnover per borrower of 7.27 times versus 2002's 6.65 times. In terms of debt repayment, the average asset-based borrower took 50.2 days to repay their loans in 2003. In 2002, it took them an average of 54.9 days to do so. Therefore, not only did these companies borrow in greater amounts, they also paid back their loans nearly five days faster.

(17) From a regional standpoint, as can be seen in **Appendix Exhibit 12**, businesses in the Northeast continued to borrow from the industry in the greatest numbers. However, the gap between this region and, again, 2003's second leading area, the Southeast, narrowed from a differential of nearly 51% in 2002 to only 33%. Interestingly, although as pointed out earlier in connection with **Appendix Exhibit 9**, the Far West had by far the largest percentage gain in advances of any U.S. region, at the same time it also had the greatest decline in the number of client borrowers both in absolute terms (-1,242 companies) and on a percentage basis (-11.9%). In addition, the size of the borrowing companies there declined from an average of 95 workers per firm in 2002 to only about 88 in 2003. In combination these figures reflect the impact of the continued negative economic conditions that have affected the high-tech, aircraft, and defense industries there.

The Far West was not alone in its loss of client company borrowers. While advances increased in every region surveyed, the number of business borrowers in each did not. Losses occurred in

the Western Midwest (-277 firms, -4.9%), the Southwest (-158 firms, -2.5%), and overseas (-116 firms, 2.2%). However, as can be seen, these reductions were much smaller than out West. The largest gain in business clients took place in the Southeast, where 2,042 companies began using asset-based financing in 2003. This was a gain of 16.3%. However, on a percentage basis the Middle Atlantic states grew the most with a 91.3% increase in new borrowers. 1,521 companies, second only to the Southeast, were added to their ranks of clients. Canada was second in growth at 28.5% (+477 new clients). Growth in the Eastern Midwest was also strong (+948 firms, +19.6%). Growth was much smaller in the Northeast (+552 firms, +2.9%), but it remains the largest borrowing market with 19,402 companies using asset-based financing funding facilities there.

(18) The typical firm that uses asset-based financing is not small. In 2003, the average borrower had 327 employees, surpassing 2002's average size of 285 jobholders (based on adjusted totals). Estimates are that over the years since 1976, the size range of the companies that use asset-based facilities has largely remained within these parameters. Thus, based on small business administration size definitions, the average industry borrower is classified as a mid-sized firm. However, as we pointed out in 2002's report, many of these client companies are much larger than this (ranging into size categories that contain over 1,000 workers), but are balanced out by even more that are much smaller (and perhaps even fall into the SBA's definition of a small firm, i.e., under 50 employees).

More interestingly, firm sizes are distinctly different among the major areas in which asset-based financing is heavily used. In the United States, the average firm had 300 workers, down from 310 in 2002. In Canada, those that use asset-based financing only had an average of 68 employees, virtually unchanged from 2002. On the other hand, the typical European firm had 831 people working for them. Thus, in Canada most of the borrowing companies are small in size, those in the U.S. fall into the middle range, while those in Europe approach being of large size. While the European information is relatively new, the trends in the other two countries have been very stable over a number of years.

Looking within specific regions of the U.S., the Eastern Midwest continues to be where the largest firms are located. Averaging 545 employees, about the same size as 2002's, firms there are 175 employees larger than those in the Southeast (397) and in the Northeast (312), the second and third ranked regions. Not coincidentally, these three areas also are the centers of heavy manufacturing in this country. There is a significant difference in size between these areas and that of the rest of the country — Middle Atlantic (167 employees), Southwest (165 employees), Western Midwest (91 employees), and, as already mentioned, the Far West (88 employees). These are locations that are centers of smaller businesses and/or non-manufacturing activities. The exception, of course, is the Northeast. Generating the greatest volume of advances of any region (\$694.2 billion) and possessing the largest number of asset-based borrowers (over 19,000 companies), it is also the home of some of the largest service providers and consulting firms in the world.



(19) As pointed out in 2002, the asset-based financing industry employs far fewer people than do those that borrow from it, and that is to be expected. What is more important is that the industry's productivity is high and continues to increase. **Appendix Exhibit 13** presents the details of its direct contribution to the nation's employment in 2003. In fact, employment in the industry has been virtually constant for the last three years. In 2003 it is up very slightly to 16,878 from 16,425, an increase of 2.78%. In the pre-recession, pre-9/11 year of 2001, it reached its all-time peak of 20,975 employees. Even applying the 2.5 times ratio of indirectly impacted employees, the total number of affected workers remains at only an additional 42,195 wage earners, or a total of 59,073 people. Of these, 55,860 were affected in the United States. This remains scarcely more than 0.04% of the employed U.S. work force. An examination of the relevant portion of that workforce, i.e., those that are involved in all financial activities, however, reveals the industry's greater employment impact. A comparison with the Bureau of Labor Statistics data on such employees indicates that the workforce constitutes still only about 0.74% of this group. Nevertheless, while employment rose by 2.78%, the overall financial sector's employment grew by only 0.97%. Moreover, through the first four months of 2004, it grew even more slowly at only 0.42%.

Even though the asset-based labor force is small, it is quite productive. Combining **Appendix Exhibit 13** with **Appendix Exhibit 9**, total and regional differences in productivity can be examined. In 2002, on average, every asset-based lender employee generated \$127.2 million. In 2003, they generated an average of \$140.3 million a 10.30% increase. This is the highest level of productivity yet reached by the employees in the industry since data on advances has been collected and is most likely to be the highest ever generated by the workforce.

Employee productivity varied quite widely among countries. In Europe and the rest of the world, lending per employee remained constant relative to 2002 at about \$51 million. In Canada, it rose substantially. Using about the same sized, small workforce, Canadian lending grew from \$74.2 million per wage earner to \$235.6 million, a 217.30% gain. In the U.S., productivity grew by 8.38% to \$142.1 million per worker.

The unexpected primary contributor to the U.S. result was the Middle Atlantic region. With an already small industry workforce there that declined by almost 40% in 2003, their productivity rose by 81.21% to \$196.9 million per employee. The Southeast was the second most productive area in this country. At \$188.5 million, it increased 26.32% in 2003. Productivity in most of the remaining regions fell within a close band around the national average. Only the Eastern Midwest fell substantially below that level. Productivity there fell 6.86% to \$105.1 million per employee.

In 2002 we evaluated a weakened level of productivity in the industry due to a number of factors enumerated there. We also forecasted that ...

It is very likely that the low productivity problems in several of these regions will be rectified next year as our members that have been adversely affected in some of these areas now have the time to make the necessary productivity improvements in 2003. (pg. 12, left column, text shortened)

Examination of this data indicates that the industry has made these adjustments. While the rate of lending increased at 13.35% (**see Appendix Exhibit 1**), staffs have increased by only 2.79%. At the same time, each industry member has raised its lending productivity by 10.30% in 2003. This has been especially the case in Canada. To a lesser extent, but still strongly, it has also been the case in the Middle Atlantic, Southwest, and Far West, in that order. Weakness remains in the Eastern Midwest and Western Midwest. In the Eastern Midwest, it remains a problem of a hard hit industrial belt that is still adjusting to economic conditions there. In the Western Midwest, it is one of an adjustment to 2002's rapid growth. Interest rates remain low and the economy is still not strong and vibrant. Thus, further improvements await these changes. Unfortunately, while so far in 2004 there has been some upward movement in rates, our economic prognosis is not bright.

(20) Another way in which to examine overall industry productivity is by comparing the size of its client companies in relation to the volume of lending to them per industry employee. Smaller companies borrow proportionately less than do larger ones and it should be expected that employee productivity would at first fall as borrowers downsized and then catch up thereafter. It is, therefore necessary to make this assessment over several years in order to capture the speed of these adjustments. Again, advances provide the basis for doing this. This is because it deals with lending activity, rather than outstandings which focuses on the availability of funds. The **Table** below presents some definitive information respecting both the changes in the size of the client companies that have done asset-based borrowing over the last seven years and the productivity of the asset-based lenders that have supplied these funds over the same period.

EMPLOYMENT — PRODUCTIVITY ANALYSIS		
Year	Client Employees	Total Advances Per Company Employee
	Per Client Company (unadjusted data)	
1997	310	\$160,290,641
1998	329	\$167,542,672
1999	306	\$150,454,035
2000	291	\$121,771,012
2001	269	\$129,871,845
2002	268	\$127,226,791
2003	274	\$140,340,739

The left-hand column presents the employment conditions among the clients of asset-based lenders over this period on an unadjusted basis. As can be seen, since the 1998 economic peak and until 2001, firms using asset-based funds reduced their staffs significantly in response to their increasing concerns respecting



economic conditions. However, this data indicate that this responsive decline in size began to flatten out in 2002. And in 2003, as predicted at this point in 2002's report ...

"The implication of this is that activity in the commercial - industrial climate is stabilizing and that there could be a turn-around in 2003 in both the size of these firms and in their short term demand for additional funds." (pg. 12, right column)

In fact, this is what took place in 2003. Indeed, it may well be possible that these borrower size adjustments represent a good barometer of prospective asset-based financing conditions.

The right-hand column presents asset-based lender productivity also over this period. The table looks farther back in time than does the discussion in Section (19) so that we can explore the industry's productivity response to its client companies' employee adjustments to expected economic conditions. A comparison of the two columns provides strong evidence that, with the exception of the recession year of 2001, asset-based lender reactions have occurred with an approximate one-year delay and in a somewhat over-reactive manner to their client companies' size adjustments. As stated earlier, in general asset-based clients have responded to their perceptions of economic conditions and the atmosphere in the markets in which they provide goods and services by adjusting employment in their firms. Although actual data on advances were not collected until 1997, estimates made for the period prior to that time indicate that borrowing continued to rise from 1991 through 1998. There is also no data on the number of company employees prior to that time. However, anecdotal information strongly indicates that the latter also rose throughout this period. As the data in the **Table** indicates, borrowers began to reduce their labor forces significantly in 1999. However, asset-based lenders did not. Industry employment rose by 5,000 in that year and by another 2,000 in the following one. Despite the record volume of total advances in 1999, as can be seen in the **Table**, per employee actually fell. It then took a huge fall in 2000 as both advances fell and employment rose. In 2001, the industry actually overcorrected somewhat as 4,500 workers were laid off. Productivity increased even though total advances continued to fall as did client company size. Since that time, employment in the industry has remained constant and adjustments to client company size have followed the latter's borrowing patterns. Thus, 2003's slight increase in borrower size and increased borrowing velocity have raised the industry's productivity by over 10%.

The information to be gained from the **Table**, in combination with **Appendix Exhibit 1**, is that the industry needs to watch future trends in client company size as well as its own advances of lending. The data collected regarding the latter is beginning to indicate that advances may be more sensitive to underlying changes in economic strength than is outstandings. Thus, it may be a good leading indicator for industry internal decision making. Client company size appears to be more of a coincident indicator of what adjustments asset-based lenders make in their current activities.

The next sections of this report examines its performance by size categories. The four size categories are arranged from smallest to largest both in terms of outstandings and advances and the criteria for inclusion within each set have been prepared so as to provide as much comparability between their respective groups. **Appendix Exhibit 14** presents the size data in terms of outstandings while **Appendix Exhibit 15** does so in terms of advances.

(21) The percentages of outstandings accounted for by each size group has remained virtually unchanged from 2002 with the largest asset-based lenders having plateaued at 95.86% of the total. Much of the reason for this has been the consolidation that has taken place among asset-based lenders in recent years. While the number of firms in the industry has declined only slightly during 2003, mergers, acquisitions, and sales of portions of commercial finance business has created some consolidation among the top two tiers of firms. Between 2002 and 2003, there were five fewer firms doing asset-based financing within the group containing the largest providers. There were also eight fewer firms doing so at the third tier as well. However, growth in numbers did occur among the smallest sized providers as eight new companies established lending bases below \$25.0 million. In terms of absolute numbers, there is now greater balance at each level than at any time since tracking such information. In fact, as can be seen in the lower half of **Appendix Exhibit 14**, each segment accounts for roughly a quarter of the companies in the industry. Thus, although the large lenders provide most of the lending base in the industry, there is still healthy competition among each of the size classes.

Just how large is the average lender within each size grouping? In 2003, the typical member of the largest company category had outstandings of \$5.17 billion. This represents an increase of 13.13% over 2002. Nearly all of this rise was due to consolidation. Similarly, the average size lender in the second size grouping had outstandings of \$216.48 million. This represents an increase of 5.76% over the prior year and is virtually the result of the contraction in the number of members contained within it. Average outstandings hardly changed within the third size category. At \$49.26 million, firms there reduced their lending base by only 0.85% in 2003. It declined by a greater percentage among the smallest firms because of the eight new entrants into it. The typical firm there provided a volume of \$11.92 million in lendable funds, an increase of 7.60%.

Another means of examining competition within these groupings is by exploring how skewed firm sizes are within them. While this is not possible to do for the largest grouping, since its size delineation is open-ended, it can be observed for the remaining sets of firms. Accordingly, the average size firm in the first two groups is slightly smaller than what might be expected. In the first group, one should expect the typical firm to have outstandings of \$12.5 million. In 2003, it was \$11.92 million. Similarly, in the second group it should have been \$62.5 million, but each averaged \$13.2 million smaller. In the third group the deviation was even larger. Expected to average \$300 million in



outstandings, in actuality their lending bases were \$83.5 million smaller. The overall implication of this is that most of the firms in each of these groups tended to be smaller than average to about average in size — a healthy competitive atmosphere within them.

(22) The pattern of activity displayed by industry advances in relation to size categories is quite different from that based on outstandings. In part, this is due to differences in turnover among the groups and in part it is due to the effects of mergers, consolidations, business segment sales, and, at the lowest end of the spectrum, to movements to the next higher category.

Between 2002 and 2003 there were eight firms that moved into the largest tier of firms. Virtually all of these were due to the mergers, consolidations, and business segment sales that took place here. We estimate that only one of the new entrants did so due to increased advances. In fact, overall, average advances per company fell by 6.98% within this grouping in 2003. In comparison, total advances there rose by 15.57%, an indication of the effects of a joining together among asset-based lenders and/or lending operations during 2003. The average advances among the firms in this group dropped by about \$4.0 billion in 2003. This is the first time that such a decline has taken place since we began collecting data on advances in 1997. However, because of the eight new additions, total advances accounted for by these firms rose by 1.96% over 2002 to over \$2.2 trillion.

Activity among those in the second tier dropped substantially. Membership was nearly unchanged with only one firm moving out of the group and into the largest size category. However, advances there declined by nearly \$17 million, or 11.74%. On a per-company basis, the typical asset-based lender within the group provided \$269 million fewer new funds to its client companies than in 2002, a decline of 10.01%. Clearly, there was far less activity going on in this upper-end, middle-market asset-based financing segment in 2003. At the lower end of this segment, proportionately more asset-based financing took place. Three new firms joined this group and average advances per company rose by 2.88% to \$455.4 million, about one-fifth of that provided the typical upper-end provider. Total lending within this segment rose by nearly \$2.3 billion, a rise of 7.17%. Nevertheless, as shown in **Appendix Exhibit 15**, the group accounted for a slightly smaller percentage of total advances in 2003 (1.44%) than in 2002. (1.52%).

Last, turn to the smallest segment of asset-based lenders — those doing under \$230 million in new financing. It was this group that appeared to have the worst performance in 2003. The data on outstandings indicate that eight additional firms fell into this comparable group in 2003 due to their declining lending base (-7.60%). However, at the same time, 12 firms moved out of the smallest group in terms of advances. This implies that the speed of lending of these rose sufficiently to move them into a higher category. Overall, what this implies is that firms that were in this

original set in 2003 increased their efficiency of lending by reducing their lending base while, at the same time, raising their volume of new lending on that base. And the data that is left supports this interpretation. The firms that remain in this group accounted for only \$5.5 billion in lending, a decline of 34.92% from 2002's figure of \$8.5 billion. Not only did their lending base fall, but so did their advances. Average advances per company declined 21.91% from \$117.6 million to only \$91.9 million in 2003. In combination, this data implies that the needs of smaller borrowers were accommodated just as well as 2002, but with greater collection efficiency by their asset-based providers.

(23) Another way of looking at collection efficiency is by examining asset-based turnover by segment. We have already explored turnover by region and for the whole industry. However, this assessment focuses more on individual company performance. It is accomplished by carrying out a comparison of such data using **Appendix Exhibits 14 and 15** in 2003 versus those for 2002. The comparisons are consistent with the data presented in Section (21) and (22).

Turnover within each of the three larger size categories are almost unchanged from 2002. However, turnover for the smallest segment fell substantially. Turnover in this group dropped from 11.32 times to only 7.00 times in 2003. While for the third tier, it rose slightly from 13.65 times to 13.87 times. The collection efficiency of the firms that remain in the fourth tier was not good. In 2002, these smallest of asset-based lenders, on average, were repaid about as fast as were those in the next two larger, middle-market segments — every 32.2 days. In 2003, they fell well below them — every 52.1 days. In comparison, the third tier firms' average Days Sales Outstanding (DSO) remained highest and stable among all four size classes — every 26.7 days in 2002 and 26.3 days in 2003. As stated earlier, three of the smaller firms moved into this group in 2002 due to their improved collection efficiency. In a similar fashion, the second largest group also did well, but not quite as well as 2002 or as the prior tier. Turnover in 2002 was 12.14 times, or collection about every 30.1 days. In 2003 it was 11.76 times, at just about this same time interval — every 31.0 days. These two figures are very consistent with the terms generally set by asset-based lenders for repayment of their collateralized loans.

Turnover for the largest of these lenders is slower. However, this is to be expected. Larger loans often take longer to repay, and the terms set for them generally reflect this. In 2002, asset-based providers in this category typically turned over borrowed debt 6.13 times. In 2003, it rose slightly to 6.75 times. On a DSO basis, collection periods were, accordingly, 59.5 days and 54.1 days. If typical terms for these larger loans are net 60 days, the industry's larger lenders are doing quite well.

The only real collection efficiency problems appear to be among those firms that remain in the smallest category of asset-based lenders. The decline in collection rates there accordingly merits additional attention in 2004 and 2005. As seen below, the outlook for these years is not bright. Thus, a weakened outlook for the economy, for business markets, and thus for the industry's



lending prospects will require much closer attention to loan repayment, especially among those whose agings are long and/or getting longer.

INDUSTRY FORECAST FOR 2004 & 2005

The 2003 report closes with the first formal forecast ever provided. When preparing the report, the economic outlook was more favorable and less uncertain. However, at this point, economic forecasts are changing almost weekly as conflicting movements among measures are arising and, in themselves, are moving up and down erratically. Throughout this report references have been made to the latest economic and market data available (through first and second quarter 2004, as available) and to this final update and forecast. In those places, we have presented the evaluation of their effects on the components of the industry's movements. At this time, preliminary July and/or third quarter 2004 have just been released.

(24) Starting at the top, Real Gross Domestic Product (GDP) will grow by 3.36% in 2004 and by 2.5 - 3.0% in 2005. While this is an admittedly low forecast, other items will support this view.

With respect to GDP alone, its most recent movement has not been positive. In 2003, it grew at only 3.04% (BEA, revised slightly downward). After growing robustly in the 3rd quarter of 2003 at 7.41%, its rate of expansion has steadily cooled. In the latest, 2nd quarter 2004, it surprised analysts by dropping to only 3.04%. Overall, as indicated in *The Wall Street Journal* (8/13/04, pg. A2), the consensus economic forecast has been revised downward to 3.8% in the 3rd quarter 2004 (from 4.4%) and to 4.1% in the 4th quarter 2004 (from 4.4%). Obviously fueling these downward projections is the price of crude oil and the effect of the continuing war in Iraq on the U.S. government's budget. Crude oil futures hit an all-time high of \$47.39 per barrel, up 71¢ in just one day. At the same time gasoline futures reached \$1.35 per gallon, up nearly 3.5¢ per gallon on that day (WSJ, 8/19/04). Finally, several respected analysts for several reasons are forecasting year-end crude prices to be at or close to \$60 per barrel.

Crude oil — gasoline prices strongly affect both retail sales and consumer confidence with a lead time of between two and six months. Thus, what is happening today will not be seen until near the end of 2004.

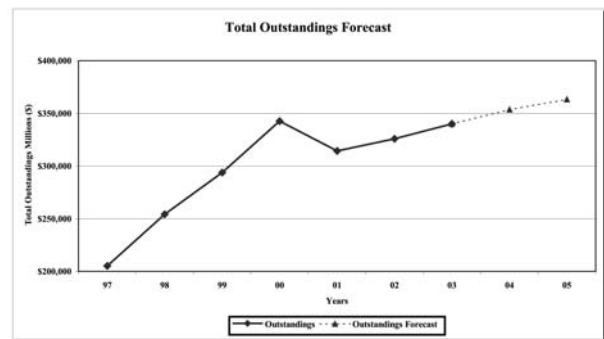
Government spending is almost always higher in a presidential election year. However, it is fueled further in 2004 as a result of the Iraqi and Afghanistan wars. While this has helped sustain the current economy, after November and our growing deficits, it is predicted that such spending will taper off.

Putting these projected events together and tying all of these to the discussions in Sections (1) and (6) of this report, we have projected outstandings to grow by 4.0% in 2004 and by between

2.5% and 3.0% in 2005. This would produce an outstandings figure of \$353.7 billion next year and a range of between \$362.5 and \$364.3 billion in 2005. These projections have been plotted below, along with the actual data since 1997 in **Text Exhibit K** below.

Presented in Sections (3), (10), and (19) are some of the economic factors that impact the industry, especially advances. Among the items discussed there were the effects of interest rates, inflation, and various aspects of manufacturing. Although other important elements also affect the industry's performance, the effects of these particular aspects of economic activity are important bellwethers in assessing movements within the industry.

Text Exhibit K



(25) As stated in the above sections, interest rates affect both the willingness of businesses to borrow as well as the industry and its competitors to lend. The low interest rates of the past encouraged borrowers to seek new funds, but have discouraged commercial banks and others from providing them. However, such rates are now beginning to move upward. At the time of writing and research for the earliest portion of this report, the 3-month Treasury Bill Rate was at 1.09% and the Prime Rate was at 4.0% (2nd quarter 2004). In July, the T-Bill rate rose to 1.33%, after the Fed raised its Fed Funds Rate. However, as of 8/19/04, T-Bills are selling at 1.47% for 91-day maturities and at 1.58% for December. If the Fed raises the Funds Rate by another 25 basis points, and their current target rate is 1.50%, we project the three-month Treasury Rate to be 1.83%. Similarly, the Prime Lending Rate in the U.S. has moved up to 4.50%. A Federal Reserve jump could, therefore, raise it to 4.75% or higher by the end of 2004.

Putting this information together, we feel that anticipatory borrowing will continue to be strong, i.e., "getting in under the wire," while competitive lending will continue to remain on the sidelines. Moreover, if a projected weaker economy scenario becomes fact, in 2005 the Fed is not likely to increase rates very much, if at all. And, if correct, this bodes well for the industry's lending opportunities.

On the other hand, one of the principle worries faced by the Federal Reserve is increasing inflation. With petroleum prices on the increase, there is also pressure on overall consumer prices. The estimate is that the All Urban Consumer Price Index (CPI) will continue to increase for the rest of 2004 and that its annual growth



turnover rate, as stated in Section (10) was 6.97 times. Thus, in 2003, our DSO has been 52.4 days. The difference of a day or two in collections means millions of dollars in extra cash for the industry over the whole year.

with range between 5.0% and 5.20%. If this takes place, it is likely that the Fed would raise its target rate twice, rather than once, before the end of 2004. Furthermore, should any negative event further shake the crude markets in 2004, inflation due to its impact would be even higher than this in 2005. If the latter were to occur, the Fed would then be forced to increase its target rate in 2005 by an additional 1.0 to 1.5%.

Producer Prices Index (PPI) measure wholesale costs to the business community. They are much more volatile than the CPI and, thus, harder to predict. Although data is available through July 2004, all of it since April is preliminary. Nevertheless, so far in 2004 average growth has been 4.51%. However, if food and energy are excluded, it has increased by 2.29%. Thus, these exclusions greatly affect business costs. With their inclusion, the PPI will rise at a rate of 5.6 - 5.7% in 2004 and between 5.0% and 7.0% in 2005. In combination, then, the Fed will be under pressure to increase its target Federal Funds Rate by at least 0.25% for the remainder of 2004 and by the additional 1.0 - 1.5% suggested above.

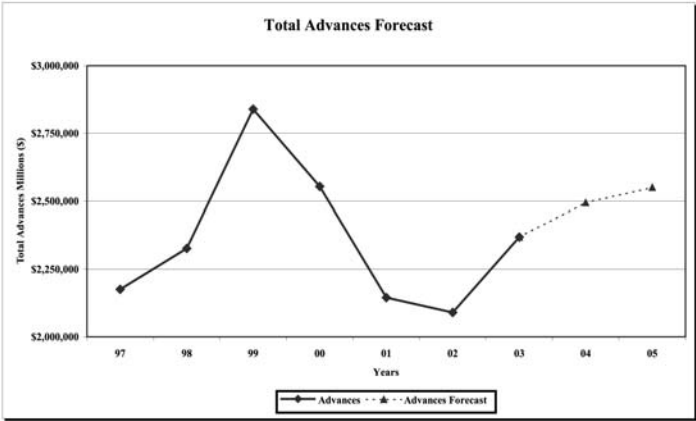
As stated in Section (3) earlier in the report, advances are driven by production demand, i.e., by the need to fill new orders and by shortages in materials and supplies inventories. Producers are paid when their products are shipped. Accordingly, we have examined these for 2004 and 2005.

New orders for the first half of 2004 have been growing at 10.6%. However, materials and supplies inventories have been rising by only 4.6%. In combination, their annual growth will be about 8.6% for 2004, but that they could slip to half that rate in 2005. Many companies are presently sitting on the sidelines with cash to spend and unused borrowing capacity. If this continues, this will dampen 2005 asset-based advances. Shipments are flowing at a rate of 13.6% in 2004 (June revised). This is up 4.3 percentage points over 2003's annual rate of 9.29%. We feel that for all of 2004 they will dip a bit, growing at 13.2%. However, with production demand down, shipments will decline with them after the first 4 - 6 months. Thus, the overall availability of cash in businesses will rise in 2005 and will put a further damper on advances.

The final forecast for the report is total advances. For 2004, it is expected to rise at between 4.6% and 6.0%, or to an average of \$2.49 trillion. However, the projected economic and product market atmosphere will weaken. Thus, the forecast total asset-based financing will increase at only 2.0% to 2.5% in 2005. This would further increase total advances to an average of \$2.55 trillion in that year. Below, in **Text Exhibit L**, we have plotted these averages in conjunction with the actual data since 1997.

Based on the projected averages for outstandings and advances for these two years, industry turnover would be 7.05 times in 2004, and 7.02 times in 2005. Both of these estimates imply improved collection times for the industry. Average DSO would be 51.8 days in 2004 and 52.0 days in 2005. 2003's actual

Text Exhibit L



This report is based on statistical information supplied by members of the Secured Finance Network and estimates from other sources involved in the asset-based financial services industry. The final figures are derived by using advanced statistical estimation and modeling methods and are the best estimates of the activities of the industry available.